AUG 1 1994

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	
	)	MM Docket 93-215
and	)	
	)	CS Docket No. 94-28
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	

REPLY COMMENTS OF VIACOM INTERNATIONAL INC.

VIACOM INTERNATIONAL INC.

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Viacom International Inc. ("Viacom"), by its attorneys, hereby submits its reply comments in the above-referenced proceeding, which seeks to establish final rules governing cost-of-service showings under cable rate regulation. These reply comments focus solely on the Commission's proposal to adopt permanent affiliate transaction rules for the cable industry based on those it has proposed for the telephone industry.[1]

As Viacom has previously commented, a focus on superficial parity in the regulation of the cable and telephone industries disserves the public interest in this context.[2] Viacom is

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[1] First Report and Order and Further Notice of Proposed Rulemaking in MM Docket No. 93-215, FCC 94-39 (rel. Mar. 30, 1994) at ¶¶ 309-313 ("Cost-of-Service Order").

[2] See, e.g., Reply Comments of Viacom International Inc. in MM Docket 93-215 (filed September 14, 1993) at 7-8. Viacom concurs with the numerous commenters in this proceeding who find affiliate transaction rules designed for the telephone industry ill-suited to the quite distinct structure and nature of the cable television industry. See, e.g., Comments of Time Warner
(continued...)

convinced that the affiliate transaction rules as proposed will harm the public interest in the creation and carriage of regulated cable programming. Accordingly, for the reasons set forth more fully below, Viacom recommends that, if the Commission adopts any rules relating to affiliate transactions, it should: (1) clarify that the level of a programmer's "output" sold to non-affiliates should be measured by the programmer's revenues; and (2) lower the percentage of output from sales to non-affiliates used to determine whether or not an affiliated cable operator is entitled to apply the prevailing company price methodology. By making these modifications, the rules will be more narrowly tailored to achieving the Commission's objective of ensuring that cable operators, while free to carry affiliated program services on regulated tiers, do not improperly pass on to cable subscribers the costs of non-regulated activities.

I. THE APPLICATION OF AFFILIATE TRANSACTION RULES DEVISED FOR THE TELEPHONE INDUSTRY WILL ADVERSELY AFFECT THE PUBLIC INTEREST IN THE AVAILABILITY OF REGULATED CABLE PROGRAM SERVICES

In designing rules for the cable industry, the Commission must ensure that the rules are carefully tailored so as not to interfere with the industry's ability to perform its core function -- delivering programming to the viewing public. Viacom

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[2](...continued) Entertainment Company, L.P. in MM Docket 93-215 (filed July 1, 1994) at 33-34.

is concerned that because the proposed affiliate transaction rules needlessly force the valuation of affiliated programming at net book cost -- a measure of value that scarcely approaches fair market value -- the public interest in the availability of diverse, high-quality regulated program services will be disserved in at least two significant respects.[3]

First, the opportunities for operators to invest in new or existing program services will be circumscribed, thus potentially depriving programmers of an historically vital source of financing and, in turn, possibly denying the viewing public of new program services and ever increasing investments in the quality of programming.[4] Such a result obviously would

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[3] Under the interim affiliate transaction rules adopted by the Commission, the sale of programming is treated as the sale of an asset. Cost-of-Service Order at ¶ 267. When an asset is sold by an affiliate, it is to be valued by the purchaser at the affiliate's "prevailing company price, if the provider has sold the same kind of asset to a substantial number of third parties at a generally available price." Id. at ¶ 263 (emphasis added). In establishing the "substantial" threshold, the Commission has proposed to use the same standard proposed for the telephone industry: an affiliated entity must sell at least 75 percent of its output to non-affiliates in order for its regulated affiliate to rely on prevailing company price methodology. Id. at ¶ 310. Failure to meet this threshold forces the regulated entity to value the cost of the asset at the lower of net book cost or fair market value. Consequently, given the structure of the cable industry, a significant number of operators would be required to value programming at net book cost.

[4] See Comments of Discovery Communications, Inc. in MM Docket 93-215 (filed July 1, 1994) at 4-5.

contravene the programming policy objective of the 1992 Cable Act.[5]

Second, contrary to the FCC goal of allowing operators to "expand the services included in the regulated program tiers,"[6] the proposed affiliate transaction rules may create incentives that would not otherwise exist for operators who have already invested in program services to migrate such services to a la carte carriage -- even though it may be economically detrimental to the service -- or, worse, to drop the services altogether. Thus, the rules would create barriers for vertically integrated operators investing in programming to invest in new program services intended to be distributed on regulated tiers. Consequently, new services looking for cable investors will increasingly find that they must create a business plan predicated only on a la carte distribution. This, in itself, may cause many such services to be stillborn. For these reasons, Viacom submits that it is imperative that the Commission modify its affiliate transaction rules as specified below to strike a

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[5] See Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. § 2(b)(3) (1992) ("It is the policy of Congress in this Act to ... ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems").

[6] Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking in MM Docket No. 92-266, FCC 94-48 (rel. March 30, 1994) at ¶ 22.

reasonable balance between preventing abuse and promoting the public interest in a range of high-quality regulated programming.

II. THE COMMISSION SHOULD CAREFULLY TAILOR ITS CABLE AFFILIATE TRANSACTION RULES TO ENSURE THAT THE PURPOSE OF THE RULES IS SERVED WHILE BURDENS ON PROGRAMMING ARE MINIMIZED

To avoid the potential adverse results described above, Viacom recommends that the Commission: (1) clarify that a programmer's output is measured on the basis of its revenues; and (2) lower the percentage of output from sales to non-affiliates that would entitle an entity to use prevailing company price methodology.

A. A Revenue-Based Measure of Output Would Best Serve the Intended Purpose of Cable Affiliate Transaction Rules

Viacom requests that the Commission clarify that, for purposes of the cable affiliate transaction rules, a programmer's output will be measured on the basis of revenue, rather than subscribers. As noted above, the Commission's current affiliate transaction rules allow the use of prevailing company price methodology if the non-regulated affiliate has "sold a substantial number of like assets to nonaffiliates,"[7] i.e., the "non-cable affiliate sells at least 75 percent of its output to

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[7] 47 C.F.R. § 76.924(i)(1).

non-affiliates."[8] Accordingly, the Commission must clarify the manner in which a programmer's output is to be quantified.

A revenue-based measure of output best fits the purpose of the rule, which is to ensure that regulated entities are not charged artificially high prices for assets purchased from non-regulated affiliates. Under this revenue-based approach, charging impermissibly high prices to affiliates would increase the likelihood of the rule coming into play. In contrast, a subscriber-based approach totally ignores the cost paid by an affiliated cable operator for the asset and thus may be either under-inclusive or over-inclusive. Accordingly, the Commission should clarify that the level of a programmer's output should be determined by looking to the programmer's total sales revenue and comparing it to the revenue derived by the programmer from sales to affiliates. This clarification would provide needed certainty, while adequately safeguarding against any potential abuse.

B. Cable Operators Should be Able to Use Prevailing Company Price Methodology as Long as They Derive 50 Percent of Their Output From Sales to Non-Affiliates

Viacom urges the Commission to lower the percentage of output from sales to non-affiliates required before cable operators can use prevailing company price methodology. Viacom believes that, rather than automatically incorporating the 75

[8] Cost-of-Service Order at ¶ 311.

percent standard found appropriate for the telephone industry, the threshold should be set at 50 percent. At this level, there still remain a "substantial number" of sales to non-affiliates sufficient to ensure that a true "market price" can be established.

The 75 percent level deemed appropriate for the telephone industry is inappropriate for cable because it ignores the fact that cable operators' traditional financial support of programming has resulted in situations in which a single programmer may have more than one affiliated cable operator. In such situations, a programmer with more than one cable operator affiliate may have sales to affiliates in excess of 25 percent of its output merely as a result of maximizing the distribution of its program service to consumers. Application of the telephone company rule in these instances thus has the perverse result that an affiliated cable operator could be forced to use net book cost to value the programming even if it paid less than a non-affiliated entity. This scenario is apt to occur because the cable operators most likely to provide financial support to programmers are generally the operators that are best able to obtain permissible volume discounts. Thus, the rules would unduly penalize the operators that have invested in program services even though the harm sought to be controlled by the affiliate transaction rules -- that a programmer would charge more than the prevailing company price to an affiliated cable operator to allow the cable operator to pass-through those costs to subscribers -- does not exist in these particular instances.

III. CONCLUSION

For the reasons set forth above, the Commission should reconsider its tentative proposal to adopt affiliate transaction rules for the cable industry that directly parallel those of the telephone industry. Differences between the industries require that the affiliate transaction rules be tailored specifically to the cable industry in order to ensure that the rules do not harm the creation and growth of programming. Accordingly, Viacom respectfully urges the Commission to clarify that output should be determined on the basis of revenue and to lower the threshold of output from sales to non-affiliates before affiliated cable operators can use prevailing company price methodology to value the cost of programming obtained from affiliates.

Respectfully submitted,

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